JOINT ECONOMIC COMMITTEE
Senator Sam Brownback — Ranking Republican Member
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RECENT ECONOMIC DEVELOPMENTS

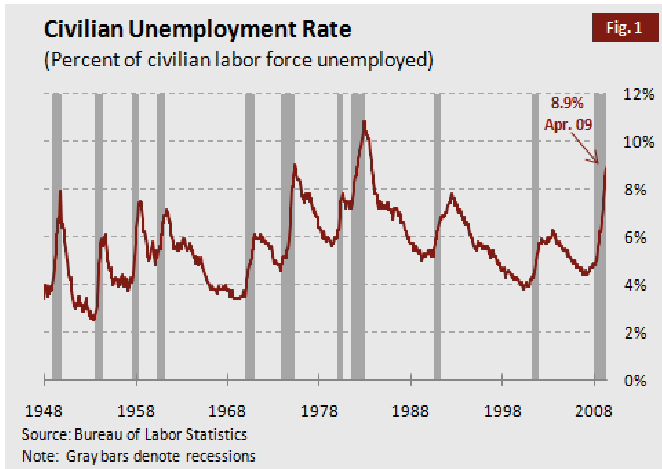
MAY 12, 2009

GREEN SHOOTS: SIGNALS OF A SLOWING PACE OF CONTRACTION?

The unemployment rate rose to 8.9% in April, significantly higher than the 5.0% rate a year earlier and a near-term low of 4.4% in March 2007. Non-farm payroll employment fell by 539,000 jobs in April and by 5.7 million since the beginning of the recession. The inflation-adjusted (real) gross domestic product (GDP) fell at a 6.1% annualized rate in the 1st quarter, following a 6.3% rate of decline in the 4th quarter of last year and a 0.5% rate of decline in the 3rd quarter. Results of "stress tests" performed on portfolios of the 19 largest U.S. bank holding companies suggest additional capital needs of $75 billion for a group of those companies. There are some very tentative signs—"green shoots"—that the pace of contraction in the economy may be subsiding, but any conclusion of bottoming out, stability, or recovery would be premature.

Highlights

- The *unemployment rate* rose to 8.9% in April, the highest since September 1983 (Fig. 1).
- *Payroll employment* fell by 539,000 in April and 5.7 million over the past 16 months (Fig. 2, next page).
- *GDP* declined at a 6.1% annualized rate in the 1st quarter, the third consecutive quarterly decline in real GDP (Fig. 3, next page).
- *Stress tests* of the 19 largest U.S. bank holding companies indicated additional capital needs of $75 billion for a group those companies (Fig. 4, next page).
- *"Green shoots,"* suggestive of a moderating pace of decline in some sectors of the economy, have emerged recently.



Unemployment Rises to 8.9%; 16 Consecutive Months of Payroll Job Declines

The *unemployment rate* rose to 8.9% in April, the highest in over 25 years (Fig. 1). The unemployment rate has risen by 4 percentage points since the beginning of the recession. *Payroll employment* fell by 539,000 jobs in April, following declines of 699,000 in March, and 681,000 in February. Federal government payrolls increased by 66,000 jobs in April, partly reflecting increases in hiring for the Census. Since the beginning of the recession in December 2007, payroll job losses have totaled 5.7 million (Fig. 2, next page). Reflecting adjustments in the housing sector, construction employment fell by 110,000 in April and is down by 1.2 million jobs since the start of the recession. Employment in the service-producing sector declined by 269,000 in April and is down by 2.9 million since the start of the recession. Manufacturing employment fell by 149,000 in April and is down by 1.6 million since the start of the recession.

GDP Declined at a 6.1% Annualized Rate in the 1st Quarter

Real GDP fell at a 6.1% annualized rate in the 1st quarter, following a 6.3% rate of decline in the 4th quarter of last year and a 0.5% decline in the 3rd quarter (Fig. 3, next page). The drop in 1st - quarter GDP primarily reflected a decline in exports (down at a 30% annualized rate), nonresidential investment (down 37.9%), residential investment (down 38%), and inventory investment (the change in inventories subtracted 2.79 percentage points from the 1st quarter change in real GDP). The slightly smaller decline in GDP in the 1st quarter relative to the 4th quarter reflected an upturn in consumer spending (up 2.2% vs. a 4.3% decline in the 4th quarter) and a larger decrease in imports (down 34.1% vs. a 17.5% decline in the 4th quarter.)

Results of the Stress Tests

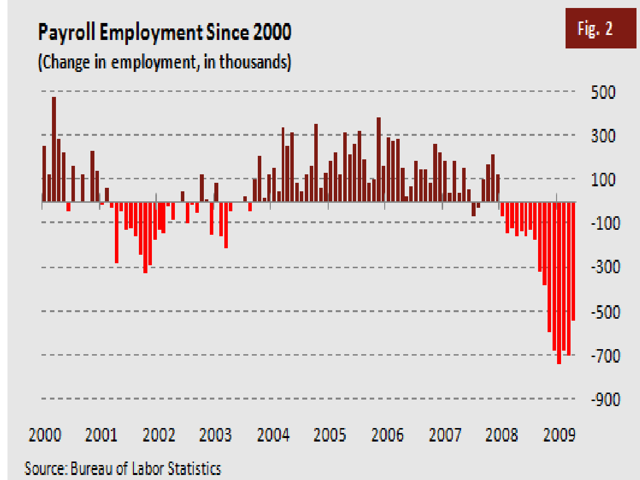
The *Federal Reserve* and other bank supervisors performed an assessment of the 19 largest U.S. bank holding companies (BHCs) in February, known as the Supervisory Capital Assessment Program (SCAP), or "*stress tests*." The purpose was to see how much of a "capital buffer," if any, each BHC would need to ensure sufficient capitalization if the economy weakens more than what examiners expected in February (the "adverse scenario"). The SCAP assessed the Tier 1 risk-based capital ratio and the proportion of Tier 1 capital that is common equity for each BHC (common equity is the first to absorb losses). The results suggest that if the economy were to evolve into the adverse scenario, losses at the 19 firms during 2009 and 2010 could be $600 billion, representing a 2-year cumulative loss-on-total-loans rate of 9.1%—higher than during the historical peak loss years of the 1930s. Of the 19 firms, as of the end of 2008, 10 would have needed a total of $185 billion of capital to reach the target SCAP capital buffer at the end of 2010 under the adverse scenario. Given asset sales or capital restructurings since the end of 2008, which reduced the SCAP capital buffer needs, additional capital needed to establish the SCAP buffer for the adverse scenario was found to equal $75 billion (Fig. 4). BHCs needing to augment capital must develop an approved capital plan and seek private capital where possible, or apply to Treasury for Mandatory Convertible Preferred under its Capital Assistance Program as a possible bridge to private capital in the future.

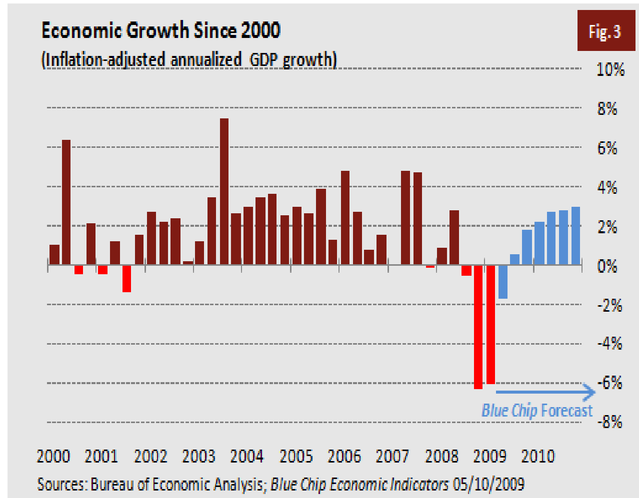
Green Shoots

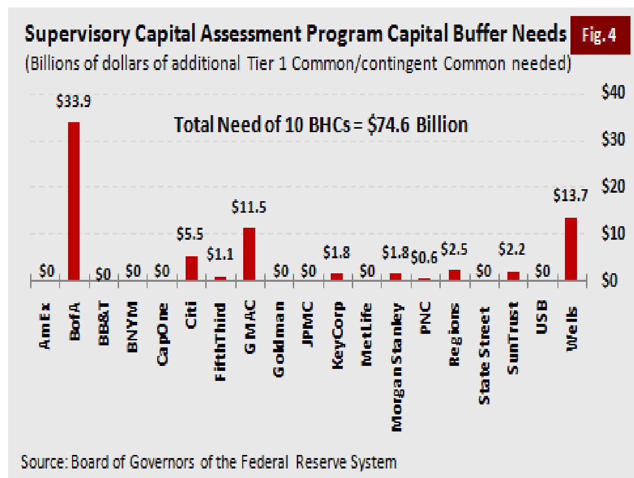
There have been recent indications that paces of decline in some economic measures have subsided. Examples are that:

- *Existing home sales, new home sales, housing starts,* and *building permits* all posted healthy gains in February, though all were followed by declines in March;
- The *Federal Housing Finance Agency (FHFA) index of home prices* increased in both January and February;
- The *Case-Shiller home price index* fell in February, but at a slower pace than in each of the prior four months;
- March and April *consumer confidence* measures increased;
- The 1st quarter rebound in *consumer spending* (up 0.5% over the 4th quarter), from two significant quarterly declines;
- Five consecutive weekly declines in the 4-week average of *initial claims for unemployment insurance;*
- An increase in the *Institute for Supply Management's* (ISM) index of *manufacturing* activity to a 7-month high in April (though, at 40.1, the index still indicates contraction—a value below 50 signals contraction, above 50 signals expansion);
- An increase in the *ISM* index of *service-sector* activity to its highest level since last October (though, at 43.7 in April, the index remains below the 50 value that signals expansion).

It is too early to declare from these tentative indicators that the recession has bottomed out, or that there are definitive trends toward stability or recovery.







Upcoming Indicators

Inflation – The Consumer Price Index for April is scheduled for release on *May 15*.

GDP – A revised estimate of the 1st quarter GDP is scheduled for release on *May 29.*

Employment – The Bureau of Labor Statistics reports on the May employment situation on *June 5.*

Federal Reserve – The Fed's next policy meeting is scheduled for *June 23 and 24.*